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May 22, 2006

**RECEIVED**

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Federal Communications Commission  
Office of Secretary

**BY HAND DELIVERY**

Ms. Marlene H. Dortch,  
Secretary  
Federal Communications Commission  
445 12th Street, S.W.  
Washington, D.C. 20554

Re: Michigan Pay Telephone Association ("MPTA") Application for  
Declaratory Ruling, FCC Dkt. No. 96-128

Dear Secretary Dortch:

The Michigan Pay Telephone Association ("MPTA"), by its attorneys, hereby submits an original and four (4) copies of a Second Petition for Declaratory Ruling ("Petition") for filing with the Federal Communications Commission ("Commission") in docket number 96-128.

MPTA seeks confidential treatment of Exhibit 6 of the filing and has included a request for confidential treatment, pursuant to Sections 0.457 and 0.459 of the Commission's Rules, 47 C.F.R. §§0.457, 0.459, of the proprietary information included in Exhibit 6. A redacted version of Exhibit 6 has been provided for public inspection.

Also enclosed is a duplicate of this filing. Kindly date-stamp the duplicate and return it to the courier.

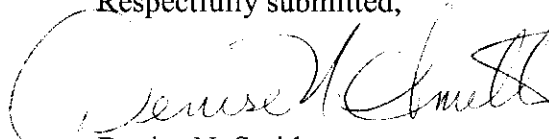
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KELLEY DRYE & WARREN LLP

Ms. Marlene Dortch  
Secretary  
May 22, 2006  
Page 2

Please contact the undersigned at (202) 342-8614, if you should have any questions regarding this filing.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "Denise N. Smith".

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*Counsel to the Michigan Pay Telephone  
Association*

DNS:pab

## BEFORE THE FEDERAL COMMUNICATIONS COMMISSION

In the Matter of	)	
	)	
Implementation of the Pay Telephone	)	
Reclassification and Compensation Provisions	)	
Of the Telecommunications Act of 1996	)	
	)	CC Docket No. 96-128
The Michigan Pay Telephone Association's	)	
Petition for Declaratory Ruling Regarding	)	
The Prices Charged by AT&T Michigan	)	
for Network Access Services	)	
Made Available to Payphone Providers in	)	
Michigan.	)	

**MICHIGAN PAY TELEPHONE ASSOCIATION'S  
SECOND PETITION FOR DECLARATORY RULING**

The Michigan Pay Telephone Association,<sup>1</sup> by its attorneys Kelley Drye & Warren LLP, hereby petitions the Federal Communications Commission ("Commission") pursuant to Sections 1.1 and 1.2 of the Commission's Rules, 47 C.F.R. §§ 1.1, 1.2, and 47 U.S.C. § 276, for the Commission to resolve an outstanding legal controversy with respect to the Commission's directives regarding intrastate payphone access line rates, and to preempt a decision by the Michigan Public Service Commission that is inconsistent with 47 U.S.C. § 276.

For the second time in this proceeding, the MPTA requests the Commission's intervention to compel AT&T Michigan<sup>2</sup> to properly implement the new services test as applied

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1 The Michigan Pay Telephone Association (hereinafter "MPTA") is a Michigan nonprofit corporation organized for the purpose of promoting and advancing the interests of Independent Payphone Providers ("IPPs") operating in the state of Michigan. The Michigan Public Service Commission is a State Commission, as that term is defined at 47 U.S.C.A. § 153(41).

2 Michigan Bell Telephone Company d/b/a AT&T Michigan is a Bell Operating Company ("BOC") and an Incumbent Local Exchange Carrier ("ILEC"), as those terms are defined under the Federal Communications Act of 1934. At the time of initiating the underlying proceeding at the Michigan Public Service Commission, Michigan Bell Telephone Company was an affiliate of Ameritech Corporation. Through various corporate transactions in the interim years, Michigan Bell Telephone Company is now an subsidiary of AT&T, Inc. For purposes of clarity, the Petitioners will refer to the entity in this Petition as AT&T Michigan, even though previous pleadings both in this proceeding and before the MPSC, the entity may have been referred to in its previous nomenclature (i.e., Ameritech Michigan, SBC Michigan, etc.)

to AT&T Michigan's payphone access rates – as this Commission has required since 1997. In 2002, this Commission held that AT&T Michigan's first attempt to implement the new services test, and the Michigan Public Service Commission's orders approving AT&T Michigan's rates, were not consistent with the FCC's mandates, and remanded the matter back to the MPSC for further deliberation.<sup>3</sup> On remand, the MPSC failed to implement this Commission's mandates with respect to one of the largest cost components the payphone providers face in their monthly billing – AT&T Michigan's usage rates.

This Commission stated that “any rate for local usage billed to a payphone line, as well as the monthly payphone line rate, must be cost-based and priced in accordance with the new services test.” In the proceeding on remand, the MPSC purportedly applied the “comparable services” standard as the method to implement the new services test – and adopted two separate, non-uniform overhead allocations in its review of AT&T Michigan's rates. Importantly, even AT&T Michigan did not advocate for such a split application of the Comparable Services methodology. The MPSC adopted a cost-based<sup>4</sup> overhead allocation rate for the monthly fixed recurring rate (i.e. the \$12.72 monthly rate for dial tone) that had been advocated by AT&T Michigan and developed pursuant to AT&T Michigan's purported payphone operations.<sup>5</sup> The MPTA does not challenge this overhead allocation. However, the MPSC also adopted a rate for local usage services of \$0.0842 per Minute of Call. This local usage rate has a second, significantly higher, non-cost based overhead allocation as compared to the cost-based overhead

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3        *In the Matter of the Michigan Pay Telephone Association, Petition for Declaratory Ruling*, CCB/CPD 99-35, ¶ 3 (“*FCC Michigan Order*”).

4        For purposes of this Petition, the MPTA does not seek Commission review of either the MPSC-approved direct costs or overhead allocation factor the MPSC adopted in its *March 2004 Order* (Tab 1) or its *Order Denying Rehearing* (Tab 2) adopted on February 10, 2005 for all non usage-sensitive services.

5        See Ex. R-71 at 1 (confidential) (Tab 6).

allocation adopted for the monthly recurring rate.<sup>6</sup> Notably, AT&T Michigan did not even request a separate, non-cost-based overhead allocation for usage, and instead requested that the Commission rely upon the same overhead for both the local usage service as it was requesting for the flat monthly portion of the rate. Notwithstanding AT&T Michigan's request, the MPSC adopted a separate overhead allocation for usage, and not only failed to identify what the overhead allocation was, but reached its conclusion by merely comparing local usage rates with the rates charged for toll usage to business customers, which is not a cost-based service. Thus, for purposes of developing cost-based rates for local usage as required under the new services test, the MPSC rationalized its finding by "comparing" local usage to the non-cost-based toll usage service – antithetical to the specific mandates of the new services test and Section 276. These defects in the MPSC's orders make the local usage rates charged to payphone providers a not-cost based rate, and therefore not in compliance with the New Services Test.

If the MPSC had applied the cost-based overhead allocation to usage that it used for the monthly rate portion of the service (as AT&T Michigan itself was advocating), then the AT&T Michigan rate for local usage would have been below \$0.02 per message. Instead, by relying on the price of toll usage to set the overhead allocation for local usage, the MPSC approved a tariffed usage rate of \$0.0842 per message, more than 600% over the direct cost.<sup>7</sup>

The Petitioner requests that the Commission review AT&T Michigan's rates for local usage (rated on a per call basis), and the MPSC's *March 2004 Order* and February 10, 2005 *Order Denying Rehearing*, and declare that AT&T Michigan's rates for usage do not comply

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6 Opinion and Order, *In the Matter of Michigan Pay Telephone Association, et al., v. SBC Michigan and Verizon North, Inc.*, MPSC Case No. U-11756, rel. March 16, 2004, p. 18-21 ("*March 2004 Order*", Tab 1). AT&T Michigan claims this overhead allocation factor to be a confidential number.

7 The test year for purposes of the record is based on rates in effect in 1998. AT&T Michigan very recently began assessing IPPs a charge for local usage in excess of \$0.11 per MOU, well more than 900% over the direct cost of providing the service.

with the new services test adopted by the FCC. AT&T Michigan and the MPSC have failed to properly apply the new services test to AT&T Michigan's local usage service in the following manner:<sup>8</sup>

a. Without explanation or justification, and despite AT&T Michigan's request otherwise, the MPSC's orders apply one overhead allocation to all services made available to IPPs except local usage, and a different and significantly higher overhead allocation to local usage. For local usage, the MPSC chose a totally different (and unknown) overhead allocation by relying on toll usage as a "comparable service." While it may be acceptable in certain circumstances to have two different overhead allocations, the MPSC must rely upon and provide an articulated rationale, justification and explanation to support using different allocations. As AT&T Michigan's Comparable Services analysis recommended a single, uniform overhead allocation, the MPSC has no justification or explanation for its use of two different overhead allocations.<sup>9</sup> This failure is improper under the new services test and federal law.

b. In relying on *toll usage* as the comparable service for purposes of calculating the appropriate overhead allocation for the *local usage* rate, the MPSC relied on an overhead allocator that is, by definition, not cost-based. Toll service is a service that is priced well in excess of cost in order to contribute to and subsidize other services. Applying a non-cost-based overhead to local usage results in the usage service also being not-cost-based. It is inconsistent with the new services test and federal law to rely upon a "comparable" overhead allocation that is, by definition, not cost-based.

c. Because local usage is one of the largest rate elements the IPP's pay on a monthly basis, the MPSC's use of an overhead allocation for local usage that is more than 6 times its direct costs is not a cost-based overhead allocation factor, and violates the new services test and federal law.

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8 The Michigan Commission has already ordered that refunds for any overcharges pursuant to the line rate are due and payable to payphone providers, to the extent that AT&T Michigan's line rates did not comply with the new services test as of April 15, 1997.

9 This finding is completely unsupported by any evidence. There is no evidence related to: (1) the overhead allocation factor applied to the toll usage direct cost to develop its tariffed rate; (2) cost studies and/or work papers supporting these figures; and, (3) any other data or documentation upon which the MPSC could rely to demonstrate that reliance on AT&T Michigan's retail toll usage rate supports a finding that its payphone local usage rate is cost-based. As even AT&T Michigan was advocating the use of a single, uniform overhead allocation, neither it nor the MPSC can point to any evidence in the record related to the supposedly-comparable toll usage rates. The MPSC's order does not comply with the new services test, and is therefore unlawful.

## **I. PROCEDURAL HISTORY**

In 1996, Congress enacted the Telecommunications Act of 1996 that substantially changed the landscape of regulation in the telecommunications industry, and made significant revisions to the Federal Communications Act. One such change was the enactment of Section 276 of the Federal Communication Act, 47 U.S.C. § 276. Congress deemed it appropriate to treat IPPs in a special manner as compared to other customers of the telephone company. Congress determined that the fundamental purpose of Section 276 was “to promote competition among payphone service providers and promote the widespread deployment of payphone services to the benefit of the general public.” Section 276 of the Federal Communications Act states in relevant part:

(a) NONDISCRIMINATION SAFEGUARDS.--After the effective date of the rules prescribed pursuant to subsection (b), any Bell operating company that provides payphone service--

(1) shall not subsidize its payphone service directly or indirectly from its telephone exchange service operations or its exchange access operations; and

(2) shall not prefer or discriminate in favor of its payphone service.

(b) REGULATIONS.--

(1) CONTENTS OF REGULATIONS.--In order to promote competition among payphone service providers and promote the widespread deployment of payphone services to the benefit of the general public, within 9 months after the date of enactment of the Telecommunications Act of 1996, the Commission shall take all actions necessary (including any reconsideration) to prescribe regulations that--

\* \* \*

(C) prescribe a set of nonstructural safeguards for Bell operating company payphone service to implement the provisions of paragraphs (1) and (2) of subsection (a), which safeguards shall, at a minimum, include the nonstructural safeguards equal to those

adopted in the Computer Inquiry-III (CC Docket No. 90-623) proceeding;

\* \* \*

(c) State preemption

To the extent that any State requirements are inconsistent with the Commission's regulations, the Commission's regulations on such matters shall preempt such State requirements.

47 U.S.C. §276.

Pursuant to Section 276(b), the Commission initiated this proceeding to determine what regulations it would develop to implement Section 276. After an extensive investigation by the FCC into the rules, regulations, and requirements necessary to implement Section 276, the FCC held that there are several *nonstructural* safeguards that are necessary to provide IPPs the opportunity to effectively compete against the telephone company's payphone operations. In its *Payphone Orders* in 1996, the Commission adopted regulations and procedures implementing Section 276.<sup>10</sup>

To guard against discrimination by incumbent local exchange carriers in the provision of network services made available to payphone providers, the Commission exercised its jurisdiction over the intrastate tariffs for these network services. The Commission required, *inter alia*, that incumbent payphone tariffs filed at the state level be cost-based, nondiscriminatory, and consistent with both Section 276 and the Commission's *Computer III* tariffing guidelines:

We require LECs to file tariffs for the basic payphone services and unbundled functionalities in the intrastate and interstate jurisdictions as discussed below.

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<sup>10</sup> *In the Matter of the Implementation of the Pay Telephone Reclassification Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-128, Report and Order, 11 FCC Rcd 20541, FCC 96-388 (released September 20, 1996) ("*Payphone Order*"); Order on Reconsideration, 11 FCC 21233, FCC 96-439 (released November 8, 1996) ("*Order on Reconsideration*"); *aff'd in part and remanded in part, sub nom. Illinois Public Telecommunications Assn. v. FCC and United States*, Case No. 96-134 (D.C. Cir. July 1, 1997); Order, FCC 97-678 (Com. Car. Bur. released April 4, 1997) ("*Bureau Waiver Order*"); Order, 12 FCC Rcd 21370, FCC 97-805 (released April 15, 1997) ("*Limited Waiver Order*"); *See also, In the Matter of Wisconsin Public Service Commission Order Directing Filings*, in CCB/CPD No. 00-1, FCC 02-25 (released January 31, 2002) ("*Wisconsin Order*") (These orders are collectively referred to herein as the "*Payphone Orders*").



LECs must file intrastate tariffs for these payphone services and any unbundled features they provide to their own payphone services. **The tariffs for these LEC payphone services must be: (1) cost based; (2) consistent with the requirements of Section 276 with regard, for example, to the removal of subsidies from exchange and exchange access services; and (3) nondiscriminatory. States must apply these requirements and the Computer III guidelines for tariffing such intrastate services. [fn.] . . . We will rely on the states to ensure that the basic payphone line is tariffed by the LECs in accordance with the requirements of Section 276. . . .** Where LECs have already filed intrastate tariffs for these services, states may, after considering the requirements of this order, the *Report and Order*, and Section 276, conclude: 1) that existing tariffs are consistent with the requirements of the *Report and Order* as revised herein; and 2) that in such case no further filings are required.<sup>11</sup>

The Commission determined that the rates assessed by LECs for payphone services tariffed at the state level must satisfy the requirements that the Commission applies to new interstate access services proposed by incumbent LECs subject to price cap regulation (the "new services test"), as codified at 47 CFR 61.49(g)(2). *Order on Reconsideration*, ¶ 163; *Limited Waiver Order*. Under the new services test regulations, AT&T Michigan is required to price its payphone network services at the direct cost of that service, plus a just and reasonable overhead allocation. Also under the new services test, local exchange carriers are required to price network services at a level that "*will not recover more than a reasonable portion of the carrier's overhead costs.*" 47 C.F.R. § 61.49(g)(2) [emphasis added.] The FCC adopted the new services test as an objective pricing standard because it recognizes that LECs have the incentive and ability to charge its payphone competitors excessive rates for network services. The FCC notes that:

Because incumbent LECs may have an incentive to charge their competitors unreasonably high prices for these services, **we conclude that the new services test is necessary to ensure that central office coin services are priced reasonably.** Incumbent LECs not currently subject to price cap regulation must submit cost support for their central office coin services, pursuant to Sections 61.38, 61.39, or 61.50(i) of the Commission's rules.

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<sup>11</sup> *Order on Reconsideration*, ¶163 [emphasis added]. Footnote 492 in the above quote cites to the "Amendments of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture, CC Docket No. 89-79, 6 FCC Rcd 4524, 5531 (1991) at paras. 38-44." See also *Limited Waiver Order*, ¶¶ 10-11.

*Payphone Order*, ¶ 146. By satisfying these requirements, the FCC believed that it will have satisfied the mandates of Section 276(b)(1) “to promote the widespread deployment of payphone services to the benefit of the general public.”

The objective of the rules adopted in this Order is "to promote competition among payphone service providers and promote the widespread deployment of payphone services to the benefit of the general public."

*Payphone Order*, ¶ 313.

Pursuant to this Commission’s mandates, AT&T Michigan filed tariffs with the MPSC in May 1997 setting forth a description of the services and rates to be charged to payphone providers pursuant to the *Payphone Orders*. The tariffs filed by AT&T Michigan were accompanied by purported cost studies supporting the tariffed rates. The rates contained in the May 1997 filing were identical to the rates in existence prior to the Commission-ordered new services test pricing standard.

On May 20, 1996, the MPTA filed a petition with the MPSC requesting that the MPSC initiate an investigation to determine whether the local exchange service tariffs filed by SBC Michigan and Verizon comply with the requirements of state and federal law. The MPSC initially refused to initiate an investigation,<sup>12</sup> thereby requiring the MPTA to file a complaint if it felt the submission was not consistent with the new services test. Thus, on August 10, 1998, the MPTA and 62 IPPs filed a complaint against AT&T Michigan, and another Michigan ILEC (GTE) alleging that the prices for services provided violated the requirements of Section 276, the FCC *Payphone Orders*, and the Michigan Telecommunications Act.<sup>13</sup>

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12 *In the matter of the Petition of the Michigan Pay Telephone Association to initiate an investigation to determine whether Michigan Bell Telephone Company d/b/a Ameritech Michigan, and GTE North Incorporated are in compliance with the Michigan Telecommunications Act and Section 276 of the Communications Act of 1934*, MPSC Docket No. U-11410, November 7, 1997 Order (“MPSC Petition Order”).

13 On May 20, 1997, the MPTA filed a petition with the MPSC requesting that that commission investigate on its own motion the tariffed rates field by AT&T Michigan and another Michigan ILEC (GTE, n/k/a Verizon) to

In its initial Opinion and Order entered in this proceeding in 1999 ("*March 1999 Order*"), the MPSC held that the rates for network services to payphone providers had been set historically at the same rates charged to business customers, and that the Complainants had failed to show that the rates charged failed the new services test. *March 1999 Order*, p. 8, Tab 3. The MPSC held AT&T Michigan's proposed rates satisfied the new services test. *Id.*<sup>14</sup>

The Complainants filed a Petition for Declaratory Ruling with the Commission in this docket. In the MPTA FCC Petition, the Petitioners requested that the FCC declare that the MPSC's *March 1999 Order* denying the Complaint was "**inconsistent with the new services test** mandated by 47 C.F.R. § 61.49, the [FCC's] orders in this proceeding, and 47 U.S.C. § 276." <sup>15</sup>

On January 31, 2002, the Commission released its *Wisconsin Order*, which clarified its previous *Payphone Orders* and reiterated the manner in which the Commission intended the Commission to evaluate the May 1997 tariff filings submitted by AT&T Michigan and to apply the new services test. The Commission entered the *Wisconsin Order* "to assist the states in applying the new services test to BOC's intrastate payphone line rates in order to ensure compliance with the *Payphone Orders* and Congress' directives in section 276." *Wisconsin*

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determine whether the rates complied with the new services test pricing standard. The MPSC denied the MPTA's petition and held that it was not compelled to initiate a case on its own motion, and that if the MPTA or any other entity believed the tariffed rates were inconsistent with the requirements of the law it should file a complaint and bear the burden of proof on that complaint. See *MPSC Petition Order*, note 12 above.

14 The Complainants petitioned the MPSC for rehearing of its conclusions with respect to the New Services Test methodologies as adopted in the Order. On May 11, 1999, the MPSC denied the Complainants' motion for rehearing. The Complainants subsequently filed an appeal of the *March 1999 Order* with the Michigan Court of Appeals, caption number 219950. On October 23, 2001, the Court of Appeals entered an order affirming the Commission's orders, and the Complainants subsequently filed a timely Application for leave to Appeal with the Michigan Supreme Court. *Michigan Pay Telephone Ass'n v. Michigan Public Service Commission*, unpublished opinion per curiam of the Court of Appeals, decided October 23, 2001, (Docket No. 219950).

15 Michigan Pay Telephone Association's Petition for Declaratory Ruling, CC Docket No. 96-128, at p. 23 ("*FCC Michigan Order*").

*Order*, ¶ 2. The Commission repeated its previous findings with regard to the appropriate manner in which to apply the new services test and held:

In the *Payphone Orders*, we required LECs to provide PSPs with local exchange services that would enable payphone service providers to offer payphone service using either “smart” or “dumb” payphones. Providing only a line, without allowing local calls over the line, does not satisfy this requirement. We required these payphone line services to be priced at cost-based rates in accordance with the new services test. ***Therefore, any rate for local usage billed to a payphone line, as well as the monthly payphone line rate, must be cost-based and priced in accordance with the new services test.*** This requirement applies regardless of whether current payphone line service tariffs specify a particular rate for payphone line usage, or whether they currently incorporate by reference the applicable rate from a business service tariff.

This conclusion advances our purpose in requiring cost-based payphone line rates in the first place. A high usage rate would undermine our and the states’ efforts to set the payphone service rates in accordance with a cost-based standard. ***A non-cost-based usage rate would also constitute an impermissible “end run” around the requirements of section 276.***

*Wisconsin Order*, ¶¶ 64-65 (emphasis added, footnotes removed). With specific regard to the overhead allocation factor, the Commission held the new services test does “not mandate uniform overhead loading, provided that the loading methodology as well as any deviation from it is justified.” *Wisconsin Order*, ¶ 52.<sup>16</sup>

The Commission also explicitly reiterated in the *Wisconsin Order* that any state regulation that is inconsistent with the cost-based mandates of the nonstructural safeguards imposed in the *Payphone Orders*, including the new services test, is preempted pursuant to Section 276(c). The Commission held as follows:

The preemption provision of section 276(c) comes strongly into play here. That provision preempts “any State requirement” that is “inconsistent with the Commission’s regulations” implemented pursuant to section 276(b)(1).

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<sup>16</sup> Citing, *In the Matter of Local Exchange Carriers’ Payphone Functions and Features*, CC Docket No. 97-140, Mem. Opinion and Order, 12 FCC Rcd 17996, 18002, ¶ 13 (October 29, 1997); *Amendment of Part 69 of the Commission’s Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture*, CC Docket No. 89-79, Report and Order and Order on Further Reconsideration and Supplemental Notice of Proposed Rulemaking, 6 FCC Rcd 4524, 4531, ¶ 44 (July 11, 1991).

Nonstructural safeguards implemented under subsection C would, of course, be implemented pursuant to section 276(b)(1) and would fall within the scope of the preemption provision. Thus, a federal policy that payphone line rates be cost-based would be binding on the states. But if sections 276(a) and (b)(1)(C) do not apply to intra- as well as interstate matters, our broad preemption authority would greatly exceed our jurisdiction to issue rules in the first place. We find no evidence that Congress intended us to implement such a fractured regime.

*Wisconsin Order*, ¶ 38.

Then on March 4, 2002, the Commission entered the *FCC Michigan Order*. In this Order, the Commission granted the MPTA's Petition for Declaratory Ruling, which had requested that the Commission find the MPSC's *March 1999 Order* was not consistent with the New Services Test. The Commission held that the *March 1999 Order* "appear[s] to be inconsistent with the *Wisconsin Order*" and then remanded the case back to the MPSC "for further state commission proceedings consistent with the [FCC] *Wisconsin Order*...." *FCC Michigan Order*, ¶ 6.

On remand, AT&T Michigan relied upon the very same cost studies it submitted in May 1997 to support its proposed direct cost on its usage sensitive services. *See*, Ex. R-71 (Tab 6) (confidential). AT&T Michigan provided its purported direct cost, or Total Long Run Service Incremental Cost ("TSLRIC"), for its local usage service made available to the Complainants on a per message basis. *Id.*, page 4, line 10. To identify and calculate its overhead allocation on remand, AT&T Michigan purported to comply with the "Comparable Services" methodology outlined in the *Wisconsin Order* (¶ 53) and developed in the *Physical Collocation Tariff Order*.<sup>17</sup>

AT&T Michigan calculated a single overhead allocation percentage for its payphone services made available to IPPs based on the average overhead allocation percentages applied to a list of eight of what it deemed "comparable" services. As the MPSC described:

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<sup>17</sup> *Local Exchange Carriers' Rates, Terms, and Conditions for Expanded Interconnection Through Physical Collocation for Special Access and Switched Transport*, CC Docket No. 93-162, Second Report and Order, 12 FCC

SBC argues that it (1) used total direct costs for SBC's payphone operations using the TSLRIC cost-based studies submitted to the Commission in May 1997; (2) determined the total overhead margin recovered on those payphone operations by subtracting the direct costs from the aggregate revenues received; and (3) divided the total overhead margin by the direct costs to develop an overhead loading factor as a percentage of direct costs.

*March 2004 Order*, p. 16.

AT&T Michigan argued that the MPSC should “maintain its current, long-standing policy that payphone services should be priced in accordance with generally applicable rates for business lines and local usage.”<sup>18</sup> However, AT&T also argued in the alternative that if the MPSC does implement the new services test, the Commission should adopt a fixed overhead allocation percentage (reflected in AT&T Michigan witness Curries' testimony at confidential exhibit R-71)<sup>19</sup> for its payphone services. AT&T Michigan did not request any different overhead allocation between its usage service, and the flat monthly rate portion of the charges.

On March 16, 2004, the MPSC entered its *Opinion and Order* after remand, in which it held, in part, that AT&T Michigan's proposed direct costs and overhead allocation percentage produce cost-based rates that satisfy the new services test with respect to all non-usage services. While the MPTA finds fault with the MPSC's analysis, the MPTA does not request that the Federal Communications Commission take any action with respect to this determination for the overhead allocation on the flat-rated monthly portion of the services.

The MPTA does, however, take issue with the manner in which the MPSC implemented the new services test for AT&T Michigan's local usage rates. Rather than apply the same cost-based methodology and overhead allocation to AT&T Michigan's local usage rate that AT&T Michigan itself advocated, the MPSC instead held that “toll service is an appropriate competitive

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Rcd 18730 (June 13, 1997) (“*Physical Collocation Tariff Order*”).

18 See, Direct Testimony of Helen Watkins, Tr. Vol. 18, p. 2327, (page 10, lines 6-8 (Tab 5)).

comparable service for local usage.” *March 2004 Order*, p. 18. The MPSC “compared” those two retail rates and held that AT&T Michigan’s 1998 local usage rate of \$0.0842 per message complied with the New Services Test.

The Complainants timely filed an Application for Rehearing on these conclusions, which the MPSC denied on February 10, 2005. *Order Denying Rehearing*, at 7 (Tab 2). The MPTA has also appealed the matter to the Michigan Court of Appeals, and that matter is still pending (*Michigan Pay Telephone Ass’n et al v. Michigan Public Service Commission*, Michigan Court of Appeals Docket Nos. 254980 and 261341 (consol.)).

## **II. THE SUBSTANTIVE ERRORS MADE BY THE MPSC.**

One of the issues the MPSC was to address on remand from this Commission’s prior order is whether AT&T Michigan and the MPSC have appropriately applied the new services test to the local usage service rate. *See, FCC Michigan Order*, ¶ 6; *March 2004 Order*, p. 18, 21. A typical payphone provider will pay AT&T Michigan a flat monthly rate for the provisioning of the payphone line itself, plus an amount for each call made from the payphone. This charge is known as the “usage sensitive service” rate element. According to AT&T Michigan’s cost studies, its tariffed rate for local usage in the test year (1998) was \$0.842 per local call; \$0.1343 for the 1<sup>st</sup> minute and \$0.0855 for each additional message for interzone messages; plus a \$0.12 surcharge for toll calls.<sup>20</sup> The prices for usage to payphone providers have actually increased, and the usage sensitive service rate element charged to payphone providers is now \$0.11 per message.

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19 Ex. R-71 at 1, (Tab 6) (confidential).

20 Since the MPSC entered its *March 2004 Order*, AT&T Michigan has raised its usage rates to more than \$0.11 per local call. See Tab 4 (in the right column, there is a section heading entitled “Local Calls”, which indicated a per call charge of \$0.11).

The MPSC held in its *March 2004 Order* that a rate set at the direct costs found in Ex. R-71 (Tab 6), plus the overhead allocation percentage factor proposed by AT&T in Ex. R-71 would produce cost-based rates for the monthly flat rate elements component of the payphone services under the New Services Test. *March 2004 Order*, p. 18, 21 (Tab 1). However, the MPSC's decision did not apply AT&T Michigan's proposed overhead allocation to its local usage sensitive service rate element.

Rather, the MPSC made a curious finding that AT&T Michigan's "toll service is an appropriate competitive comparable service for local usage." *March 2004 Order*, p. 18.<sup>21</sup> This finding is not consistent with the new services test and federal law for a number of reasons, nor did AT&T Michigan even advocate for that result.

**A. The MPSC fails to justify or explain applying one cost-based overhead allocation for every payphone access service with the exception of local usage.**

Without explanation or justification, the MPSC's orders apply a cost-based overhead allocation to all services made available to IPPs with a single exception – local usage. For that single service, the MPSC applied a significantly higher overhead allocation, by orders of magnitude. For local usage, the MPSC chose a totally different (and unknown) overhead allocation by relying on toll usage as a "comparable service".

This Commission has held that there are occasions when it is acceptable in certain circumstances to have non-uniform overhead allocations. However, each time this Commission has so ruled, it has made clear that any non-uniform overhead allocations must be fully justified

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21 This finding is completely unsupported by any evidence. There is no evidence related to: (1) AT&T Michigan's actual direct cost of its toll usage service; (2) the overhead allocation factor applied to that direct cost to develop its tariffed rate; (3) cost studies and/or work papers supporting these figures; and, (4) any other data or documentation upon which the MPSC could rely to demonstrate that reliance on AT&T Michigan's retail toll usage rate supports a finding that its payphone local usage rate is cost-based. Neither AT&T Michigan nor the MPSC can point to any evidence in the record related to the supposedly-comparable toll usage rates. The MPSC's order does not comply with the new services test, and is therefore unlawful.



in order to satisfy the new services test. For instance, in the *Wisconsin Order*, the Commission reiterated that the new services test does “not mandate uniform overhead loading, *provided that the loading methodology as well as any deviation from it is justified.*” *Wisconsin Order*, ¶ 52 (emphasis added). The Commission further reasserted that the burden for justifying the overhead allocations and demonstrating compliance with the new services test remains with the incumbent LECs like AT&T Michigan. *Id.*, ¶ 58.

The *Wisconsin Order*’s statement that the new services test requires justification for any non-uniform overhead allocation is not a new development. In fact, the Commission has a long string of orders dating back to at least 1993 that support the *Wisconsin Order*’s finding that non-uniform overhead allocations are allowable under the new services test, but only in limited, justified circumstances. For instance, in the *Part 69/ONA Order*, the Commission addressed the LECs’ varying overhead allocations. The Commission made clear that any non-uniform overhead allocations must be fully justified in order to pass the new services test:

We conclude that the nonuniform loadings at issue here, whose nonuniformity is due solely to mathematical rounding, are reasonable. Since the BSE rates in these cases are fractions of a cent per unit, it is often very difficult for carriers to load overhead costs on BSEs at exactly the same rate for all. Similarly, as the overhead loadings for special access services have always been different from those for switched access services, we find that PacTel has in this instance adequately justified its nonuniform loading for Network Reconfiguration.

*Part 69/ONA Order*, ¶ 52.

Similarly, in the *Payphone Features Order*, the Commission again reiterated that the new services test does not mandate uniform overhead allocations, provided that the loading methodology as well as any deviation from it is justified. *In the Matter of Local Exchange Carriers’ Payphone Functions and Features, GTE Telephone Operating Companies Revisions to Tariff F.C.C. No. 1*, CC Docket 97-140, FCC 97-392 (October 29, 1997) (“*Payphone Features*

*Order*”). This Commission has also made clear that when the non-uniform overhead allocations are not justified or explained, the resulting rates are unlawful and must be rejected. *Payphone Features Order*, ¶ 23. In the *Payphone Features Order* the Commission held that GTE failed to “explain how this charge was derived consistent with the new services test. ... Accordingly, we find that GTE has failed on this record to justify its \$5.00 nonrecurring charge for SCOCs. We therefore find this charge unlawful on this record.” *Payphone Features Order*, ¶ 23.

In the present case, AT&T Michigan did not provide any justification for a non-uniform overhead allocation, and the MPSC gave no justification in its orders. In fact, AT&T Michigan advocated for a single, uniform overhead allocation to be applied to all payphone services, including local usage.

The MPSC cannot cite to any actual evidence to justify its approval of non-uniform overhead allocations. Moreover, because it was advocating a single, uniform overhead allocation for all payphone services and not the nonuniform overheads the MPSC adopted, AT&T Michigan did not provide any evidence related to its toll usage rates – i.e., it did not provide the actual toll usage rates, the then-current toll usage overhead allocation, cost studies in support of the toll usage overhead allocation, or how that overhead allocations may relate to that assigned to local usage.

This Commission has held that failure to provide evidentiary explanation and justification for findings under the new services test makes those rates unlawful, and the MPSC’s orders with respect to the rates for local usage are therefore unlawful.

**B. The new services test forbids the “comparison” to a non-cost based service like toll usage in developing cost-based rates for payphone services.**

In addition to requiring that the MPSC justify its adoption of non-uniform overhead allocations, the new services test requires the service to which a comparison is being made be

cost-based as well. If the service to which a comparison is being made is set so as to subsidize other services, it is not cost-based. Concomitantly, for purposes of developing a rate that satisfies the cost-based mandates of the new services test, a non-cost-based “comparable” service cannot be relied upon under the new services test.

In the present case, the MPSC relied upon the supposedly comparable toll usage rates to satisfy the cost-based requirement for the overhead allocation of local usage services. However, as a general matter, toll usage service rates have historically been set artificially high in order to contribute and subsidize other services – i.e., toll usage rates are set based upon an overhead allocation that is not cost-based.<sup>22</sup> Setting a local usage rate using an overhead allocation from a different service that has historically been used to subsidize other services results in setting the local usage rate so as to subsidize other services. The FCC Bureau rejected this approach in the *Bureau Order*, where it stated that “overhead allocations must be based on cost, and therefore may not be set artificially high in order to subsidize or contribute to other LEC services.”

The MPSC’s “comparing” AT&T Michigan’s non-cost-based toll usage rate to its local usage rate results in the local usage rate also being set at a non-cost-based level. It is inconsistent with the new services test and federal law to rely upon a “comparable” overhead allocation that is, by definition, not cost-based. The MPSC’s Orders allow usage rates to be set at the same overhead allocations that apply to the rates charged to business customers, something which this Commission specifically prohibited in the *Wisconsin Order*. *Wisconsin Order*, ¶ 64.

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22 See, e.g., First Report and Order, *In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges* (CC Docket Nos. 96-262, 94-1, 91-213, and 95-72 (rel. May 16, 1997) (“Access Charge Reform Order”), where the Commission noted in ¶ 11 that toll usage rates subsidize low residential basic service:

**States have maintained low residential basic service rates through, among other things, a combination of: geographic rate averaging, high rates for business customers, high intrastate access rates, high rates for intrastate toll service, and high rates for vertical features and services such as call waiting and call forwarding.**

**C. Use of an overhead allocation that is more than 6 times the direct cost of a service is not consistent with the new services test.**

As detailed above, the MPSC adopted a rate for local usage that is more than 600% over the direct cost of the service, or more than 6 times its direct costs. Because local usage is one of the largest rate elements the IPP's face on a monthly basis in Michigan, the MPSC's use of an overhead allocation for local usage that is more than 6 times its direct costs, could not under any circumstance, be considered a cost-based overhead allocation factor.

This Commission has, in the past, allowed rates with overhead allocations of up to 3.4 times direct cost to go into effect. See, *Payphone Features Order*, ¶¶ 11-14. However, the Commission expressly allowed such seemingly excessive overhead allocations to go into effect because "these services are provided either at very low rates or at no charge." *Payphone Features Order*, ¶ 13. Neither of these two facts present themselves in the present Petition. As demonstrated in the attached sample billing of one Michigan IPP from March 2006, AT&T Michigan's local usage rate accounts for up to 68% of the monthly bill assessed for the payphone. See Tab 4.<sup>23</sup>

Moreover, this Commission has recognized that the *Payphone Features Order* permitted an "an unusually high overhead loading" based on the fact that the incumbent carriers had justified those overhead loadings. *Wisconsin Order*, ¶ 57. In fact, the Commission stressed that the decision "was specific to the circumstances of the particular investigation, which involved payphone features whose monthly costs did not exceed a few cents per line." *Id.*

Local usage is one of the, if not the, largest rate elements the IPP's face on a monthly basis in Michigan. It is critical that the local usage rates be set at cost-based rates if the corresponding benefits of widespread deployment of payphones are to be accomplished. The

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23 In the right column, there is a section heading entitled "Local Calls" indicating a per call rate of \$0.11.

MPSC has failed to accomplish that task. The MPSC's use of an overhead allocation for local usage that is more than 6 times its direct costs is not a cost-based overhead allocation factor, and violates the new services test and federal law.

### **III. REQUEST FOR RELIEF**

In adopting Section 276, Congress specifically established a policy to “promote the widespread deployment of payphone services.” Section 276(b)(1). One way this Commission determined to promote the widespread deployment of payphones is to mandate cost-based rates set pursuant to the new services test regulations for all payphone services the IPPs purchase from the incumbent. See, e.g., *Order on Reconsideration*, ¶ 163.

It is without question that this Commission requires that “any rate for local usage billed to a payphone line, as well as the monthly payphone line rate, must be cost-based and priced in accordance with the new services test.” *Wisconsin Order*, ¶ 64. The Commission has stated that “a non-cost-based usage rate would also constitute an impermissible “end run” around the requirements of section 276.” *Id.*, ¶ 65.

The MPSC erred by failing to apply the cost-based requirements of its new services test regulations on AT&T Michigan's local usage service rates. The MPSC specifically relied upon a comparison to a toll usage service for which it did not have the overhead allocation factor applied to its direct cost to develop the retail tariffed rate, work papers supporting those calculations or any other evidence to support its finding. As such, the record below precludes any conclusion that the local usage rates assessed the IPPs are cost-based. The MPSC erred in applying the new services test, and this Commission must clearly and affirmatively enforce its previous *Payphone Orders* and new services test regulations by declaring that AT&T Michigan's local usage service rate must be capped at no more than the MPSC-approved direct cost for local usage, plus the MPSC-approved, cost-based overhead allocation factor approved for all other

payphone services. This is the approach that AT&T Michigan itself advocated in the testimony below. It will serve the public interest for the Commission to clarify its standards in applying the new services test to the rates charged by AT&T Michigan.

Congress has preempted any state requirements that are inconsistent with the Commission's regulations, including the new services test regulations. 47 U.S.C.A. § 276(c), *Wisconsin Order*, ¶ 38. As demonstrated above, the *March 2004 Order* fails to apply the cost-based standards of the new services test regulations on AT&T Michigan's local usage service rate. The Commission made clear that such a determination is not consistent with the new services regulations. *Wisconsin Order*, ¶¶ 64-65. Because the MPSC's determinations are in conflict with the mandates of the Commission's new services test regulations, the Commission must declare the MPSC's findings with respect to usage sensitive services to be preempted pursuant to Section 276(c).

Further, the Commission must reiterate that AT&T Michigan is obligated to apply the new services test formula on "local usage billed to a payphone line, as well as the monthly payphone line". *Wisconsin Order*, ¶¶ 64-65. If such a calculation results in a lowering of the lawful usage service rate, then that rate was unlawfully set in excess of its cost-based level in violation of the new services test and refunds are due the IPPs going back to April 15, 1997.

Because of the MPSC's utter failure, after having been given two opportunities, to comply with this Commission's clear mandates and directives, the MPTA requests this Commission enforce its previous *Payphone Orders* and new services test regulations, and issue an order finding as follows:

- a. declare that the MPSC failed to apply the new services test to AT&T Michigan's local usage sensitive services;

- b. declare that the MPSC failed to identify and apply a cost-based overhead allocation for local usage services to establish a cost-based rate for those services;
- c. declare that, in light of the MPSC's failure to justify the variance, it was improper for the MPSC to apply non-uniform overhead allocations to the payphone services; one for the flat monthly rates charged by AT&T Michigan, and a different, non-cost based overhead allocation for local usage.
- d. declare that the MPSC's reliance on the non-cost-based overhead allocation associated with AT&T Michigan's retail toll usage service as the "comparable" service for purposes of determining whether the local usage rate satisfies the cost-based mandates of the new services test is inconsistent with the Commission's regulations;
- e. declare that, because local usage is one of the largest rate elements the IPPS face on a monthly basis in Michigan, the MPSC's use of an overhead allocation for local usage that is more than 6 times its direct costs is not a cost-based overhead allocation factor, and violates the new services test and federal law;
- f. declare that AT&T Michigan's current tariffed rate for local usage services made available to payphone providers is unlawful and in violation of the new services test regulations, the Commission's *Payphone Orders*, and Section 276;
- g. declare that the MPSC's decision to rely upon AT&T Michigan's retail toll usage rate as a "comparable" service for its local usage service rates made available to payphone providers does not comply with the cost-based new services test, and results in unjust, unreasonable and unlawful rates;
- h. declare that AT&T Michigan must revise its intrastate tariffs to comply with the new services test as described above; and,
- i. declare that, to the extent that the MPSC failed to properly apply the new services test to AT&T Michigan's usage sensitive service rates in a manner that is consistent with the Commission's new services test regulations, then the *March 2004 Order* and the *Order Denying Rehearing* are both preempted pursuant to Section 276(c).

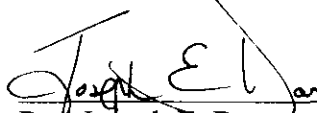
## CONCLUSION

Wherefore, for each of the foregoing reasons, the Michigan Pay Telephone Association request that the Commission review the decision of the Michigan Public Service Commission and declare the *March 2004 Order* unlawful as described above. The Commission must declare the findings of the *March 2004 Order* and the *Order Denying Rehearing* as related to AT&T Michigan's usage sensitive services are preempted pursuant to Section 276(c).

Respectfully submitted,

May 19, 2006

MICHIGAN PAY TELEPHONE ASSOCIATION

A handwritten signature in black ink, appearing to read "Joseph E. Donovan", is written over a horizontal line.

By: Joseph E. Donovan, one of the attorneys for the  
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